

ICRA Lanka revises the rating of DFCC Bank PLC

August 23, 2022

Instrument	Rated Amount (LKR Mn)	Rating Action
Issuer Rating	NA	Revised to [SL]A+ (Negative) from [SL]AA- on watch with Negative implications

Rating action

ICRA Lanka Limited has revised the Issuer Rating of DFCC Bank PLC (“DFCC” / “the Bank”) to [SL]A+ (pronounced as S L A plus) from [SL]AA- (pronounced as S L double A minus) and revised the outlook to negative from rating on watch with Negative implications.

Rationale

The rating downgrade was mainly due to moderate capital buffers and weakening asset quality indicators of the Bank. DFCC reported a marginal buffer over its capital adequacy ratios with a Tier 1 capital adequacy ratio of 8.97% as on March 31, 2022 against a regulatory requirement of 8.00%. The total capital adequacy ratio was 12.25% against 12.00% regulatory requirement. In order to improve the Bank’s Tier 1 capital base to support the business growth, DFCC Bank carried out a rights issue in May 2022. Amidst the broad macro instability and extremely weak equity market outlook, the Bank was able to raise LKR 3.62 Bn (60%) of the estimated LKR 6 Bn rights issue. Post the rights issue, the Tier 1 capital adequacy ratio and the total capital adequacy ratio improved to 10.84% and 14.14% respectively as on June 30, 2022. Going forward, capitalisation profile will remain a key monitorable with the profitability outlook for the banking sector remaining weak for CY2022 given the expected margin compression, higher impairment charges and taxes.

The ratings also factor in the envisaged pressure on the Bank’s asset quality indicators. The impaired loans ratio marginally increased to 3.13% as on March 31, 2022 from 3.03% as on December 31, 2021. ICRA Lanka expects the same to deteriorate further in H2CY2022, due to the aggravated macro challenges.

DFCC Bank reported a Net Interest Margin (NIM) of 3.75% in Q1CY2022, higher than 2.32% in Q1CY2021. Due to DFCC’s moderate dependence on public deposits and the time lag in repricing the deposits, the Net interest margin improved to 4.42% in H1CY2022 as well. While the bank has more flexibility in terms of asset repricing, the sharp increase in systemic interest rates in April 2022 and further in July 2022 will affect its core margins somewhat due to the deposit repricing effect and is likely to be reflected in H2CY2022 financials. The effect of any haircut from the sovereign debt restructuring will be lower for DFCC as the investments in International Sovereign Bonds accounted for only 1% of the total asset base as on December 31, 2021. The credit cost (Provisioning/ATA) sharply increased to 2.23% in Q1CY2022 in comparison to 0.31% in Q1CY2021. ICRA Lanka envisages the earnings profile to remain weak from the expected higher impairment charges resulting from the heightened economic risk.

Please refer our previous rating rationale on the revision of DFCC Bank’s outlook <https://www.icralanka.com/rationale/dfcc-bank-plc-rating-reaffirmed-outlook-revised-to-negative/>

Outlook: Negative

The negative outlook reflects weak capital buffers of the Bank and envisaged weakening of the asset quality indicators. The outlook may be revised to 'Stable' in case of a steady improvement in its capital profile with healthy buffers over the regulatory requirements while also improving and maintaining healthy asset quality indicators and liquidity profile.

Analytical approach: For arriving at the ratings, ICRA has applied its rating methodologies as indicated below.
Links to applicable criteria: <https://www.icralanka.com/rating-methodology-for-banks/>

About the Bank:

DFCC Bank was set up in 1955 as Sri Lanka's first Development Finance Institution on the recommendation of the World Bank and is one of the oldest development banks in Asia. In October 2015, DFCC Bank and its 99% owned subsidiary, DFCC Vardhana Bank amalgamated to become a commercial bank. DFCC Bank is now a Licensed Commercial Bank offering a range of development banking and commercial banking products and services. The Bank is involved in commercial lending activities such as project financing, and trade finance, and SME finance, while also providing the full range of retail banking products, such as housing loans, personal loans, leases, and credit cards.

For Q1CY2022, DFCC Bank reported a profit after tax of LKR 367 Mn on a total asset base of LKR 523,732 Mn in comparison to LKR 1,479 Mn PAT in Q1CY2021 on a total asset base of LKR 460,449 Mn. During the calendar year ended December 31, 2021, DFCC Bank reported a profit after tax of LKR 3,222 Mn on a total asset base of LKR 485,505 Mn.

Key financial indicators

LKR Mn	CY2020	CY2021	Q1CY2021*	Q1CY2022*
Net Interest Income	11,007	12,653	2,679	4,727
Profit after Tax/ (Loss)	2,388	3,222	1,479	367
Net worth	49,357	48,986	50,756	40,028
Loans and Advances (Net)	301,909	365,901	314,562	392,640
Total Assets	465,077	485,505	460,449	523,732
Return on Equity	4.93%	6.55%	11.82%	3.29%
Return on Assets (On PAT)	0.55%	0.68%	1.28%	0.29%
Capital Adequacy Ratio (Tier 1)	10.82%	9.31%	10.21%	8.97%
Gearing (times)	8.25	8.73	7.91	11.83 ¹

*Unaudited Financials

Rating history for last three years:

Instrument	Current Rating			Chronology of Rating History for the past 3 years		
	Type	Amount Rated (LKR Mn)	Date & Rating in CY2022	Date & Rating in CY2022	Date & Rating in CY2020	
			Aug 2022	May 2022	April 2022	Dec 2020
Issuer Rating	N/A	N/A	[SL]A+ (Negative)	[SL]AA-; placed on watch with negative implications	[SL]AA- (Negative)	[SL]AA- (Stable)

¹ Increased gearing (times) in Q1CY2022 is due to the sharp rupee depreciation. DFCC Bank has sizeable foreign-currency borrowings from multilateral and bilateral institutions.



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